

TRANSFERS SUBJECT TO RETAINED RIGHT TO RECEIVE THE INCOME OR DESIGNATE THE INCOME BENEFICIARY

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I. INTRODUCTION

Section 2036(a)(1) of the Internal Revenue Code¹ throws back into the decedent's gross estate the value of transferred property if the decedent retained the right to receive the income from the property (a) for his life, (b) for any period not ascertainable without reference to his death (e.g., quarterly, except for the quarter immediately preceding his death), or (c) for any period that does not in fact end before his death (e.g., for ten years, if he dies during this period). This provision also applies if the decedent retained "possession or enjoyment" of the transferred property, thus reaching property that does not produce income in the conventional sense, such as a work of art given to a donee subject to the donor's right to retain it in his home for life or for either of the two other periods specified by section 2036(a)(1).

A companion provision, section 2036(a)(2), imposes parallel treatment if the decedent retained the right, either alone or in conjunction with another person, to "designate" the persons who shall possess or enjoy the property or the income therefrom, even if the decedent cannot vest these benefits in himself. At first blush, the naked term "designate" might seem applicable only if the decedent had a relatively free hand in selecting a person to receive the income. The cases, however, construe section 2036(a)(2) very broadly, finding a right to "designate" the income beneficiary implicit in virtually any reserved power over enjoyment of the property.² As a result, section 2036(a)(2) often overlaps with section 2038,³ which relates to powers to alter, amend, revoke or terminate enjoyment of transferred property.⁴

Although both sections 2036(a)(1) and 2036(a)(2) require the value of the underlying *property* to be included in the decedent's gross estate if he retained a right to receive or control the *income*, a lesser amount is includible if the decedent's retained right does not encompass all of the income. For example, if the decedent retained the right to receive one-half of the income generated by the transferred property, only one-half of its value is includible. Similar, but more complicated, adjustments are required if the decedent's right was limited to either a

publication in the fall of 1983. The completed work will include a discussion of *United States v. Byrum*, 408 U.S. 125 (1972), and of its legislative sequel, Section 2036(b) (retention of right to vote stock of controlled corporation constitutes retention of enjoyment within meaning of I.R.C. § 2036(a)(1); this material was not available when this article went to press.

1. I.R.C. § 2036(a)(1) (West 1979).

2. See *infra* notes 50-65 and accompanying text.

3. I.R.C. § 2038 (West 1979).

4. For problems in determining the amount includible in the gross estate if both §§ 2036 and 2038 apply, see *infra* text accompanying note 107.

specified dollar amount of income or the excess above a specified dollar amount.⁵

From the early days of the federal estate tax, transfers of property subject to a reserved life estate in the transferor have been widely viewed as quasi-testamentary dispositions, and hence proper targets for taxation on the transferor's death. Since persons of substantial wealth often live on their income and have little need to invade capital, judges and tax theorists have argued that the retention of a life estate preserves for the decedent the most important aspect of ownership, and that a gift of the remainder interest merely anticipates a disposition that would otherwise have occurred at the decedent's death. Judge Learned Hand, for example, observed that "if the donor reserves the income [from transferred property] to himself during his life, it is as nearly the substitute for a bequest as it can be and still remain a gift at all"⁶ In an earlier case involving a state inheritance tax, the New York Court of Appeals said that "an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate."⁷

In arguing that these transfers perpetuate the substance of ownership for the donor and give the donee only the promise of future enjoyment, tax theorists have focused primarily on transfer arrangements under which the donor is entitled to receive the income personally. The same rationale, however, can be extended to so-called non-beneficial powers, such as the right to spread the income among persons to be designated by the donor. Even though the donor does not necessarily derive any direct economic benefit from powers of this type, the power to decide from time to time which of the potential beneficiaries shall get the income is one of the most pleasurable aspects of "ownership."

The substantial-ownership rationale for section 2036 has been so insistently drummed into students—including the author—for so many years that it has become an article of faith for most tax commentators. From time to time, however, nagging doubts about its validity arise in the minds of those who know that section 2036 can be easily sidestepped, and that the detour would be difficult to block. These doubts can be illustrated by assuming that A, with a life expectancy of ten years, is about to transfer \$100,000 in trust for B, retaining a life estate. If A is smart or well advised, he will realize that he has two separate objectives: to receive the income from the \$100,000 for

5. Treas. Reg. § 20.2036-1(a) (1960) (penultimate sentence). See *Estate of Arents v. Commissioner*, 34 T.C. 274, 283 (1960) (retained interest was totally valueless), *rev'd*, 297 F.2d 894 (2d Cir. 1962). See generally *Industrial Trust Co. v. Commissioner*, 165 F.2d 142, 147 (1st Cir. 1947) (adjustment for annuity preceding decedent's right to control income); *Estate of Tomec v. Commissioner*, 40 T.C. 134 (1963) (same).

6. *Vanderlip v. Commissioner*, 155 F.2d 152, 154 (2d Cir.), *cert. denied*, 329 U.S. 728 (1946).

7. *In re Keeney*, 194 N.Y. 281, 287, 87 N.E. 428 (1909), *aff'd*, 222 U.S. 525 (1912).

life (to finance his living expenses or accumulate for reinvestment), and to give *B* \$100,000 when the trust terminates.

These two components of *A*'s plan are separated for federal gift tax purposes, since only the value of *B*'s remainder interest is a taxable gift; but they are combined to meet the statutory requirements of section 2036(a), since the plan contemplates a transfer of property subject to a retained right to receive the income. But what man hath joined, man can put asunder. Assuming a ten percent compounded yield on the proposed gift for ten years, *A* can assure *B* of the targeted \$100,000 at that time by putting \$38,554 into a trust to accumulate the income for ten years and pay the accumulated income and principal on termination to *B*. An accumulation trust of this type is not includible in the grantor's gross estate, since it does not leave him with control, and the fact that the trust terminates on his death is without estate tax consequences.

Example 1 compares *A*'s original plan with the revised accumulation-trust plan, and shows at line 6 that both plans give *B* \$100,000 when the trust terminates.

Example 1

TRUST WITH RETAINED LIFE ESTATE VS. ACCUMULATION TRUST

	Trust Subject to Retained Life Estate	Accumulation Trust
1. Amount transferred	\$100,000	\$ 38,554
2. Income per year (at 10 %)	\$ 10,000	\$ 3,855
3. Less: Annual distribution to donor	<u>\$ 10,000</u>	<u>—</u>
4. Amount accumulated	—	\$ 3,855
5. Value of accumulation (line 4 × 10 % compounded for 10 years)	—	\$ 61,446
6. Distribution on termination (line 1 plus line 5)	\$100,000	\$100,000

The original plan assured *A* of \$10,000 annually for the life of the trust, while the accumulation trust contemplated by the revised plan will pay him nothing. But since the revised plan calls for a transfer of only \$38,554 to the accumulation trust, *A* is left with the balance of the \$100,000 he initially proposed to transfer in trust to *B*, \$61,446. Invested at ten percent, this is enough to assure him of an annuity of \$10,000 for a ten-year period, at the end of which the invested amount will be exhausted—the same result that would have been achieved under the original plan, assuming that *A*'s life will correspond to his life expectancy.

To complete the comparison between the two plans, attention should be shifted to the \$10,000 that A will get under either plan for the hypothetical ten-year period. If A spends these amounts for living expenses, no residue will be left for inclusion in his gross estate under section 2033,⁸ relating to property owned at death, whether the \$10,000 is realized by A under the original or the revised plan. On the other hand, if A saves and reinvests the annual receipts of \$10,000, his gross estate will include the accumulated investment pursuant to section 2033 under both plans.

The revised plan avoids the application of section 2036(a)(1) while achieving substantially the same economic results as the original plan for both A and B, if A's actual life is identical to his life expectancy. If, however, A outlives his life expectancy and has a continuing need for income, he will regret his decision to shift from his original plan to the revised plan. He can, however, modify the revised plan to protect himself by using the retained \$61,446 to purchase a single premium annuity contract instead of investing it on his own. Since the insurance company takes advantage of the law of averages, this should guarantee A the same \$10,000 a year that he has counted on, except that it will be paid for life, not for ten years. Moreover, if A wants B to get his \$100,000 on A's death, rather than at the end of the ten-year period, A can use the \$38,554 earmarked for B to purchase a single premium term insurance policy paying \$100,000 on A's death and give the policy to B. Assuming that A is insurable, such a policy could be purchased separately from the hypothetical annuity contract. It is well established that the two would not be aggregated in applying section 2036(a)(1) even though their combined effects would be virtually identical to A's original plan of transferring \$100,000 in trust subject to a retained life estate.⁹

This comparison between the original retained life estate plan and the accumulation-retention insurance-annuity plan assumes that the two plans entail comparable transaction costs. The comparison also disregards differences in the various plans' income tax consequences, which can be mitigated or neutralized by changing the \$38,554/\$61,446 ratio of transferred to retained funds.

The disparity in tax results described above seems likely to persist, since Congress has not exhibited any intent to close the gap, either by repealing section 2036(a) or by providing that accumulation trusts that terminate on the grantor's death are includible in the grantor's gross estate.

8. I.R.C. § 2033 (1976).

9. See *Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274 (1958) (proceeds of life insurance policies, payable and assigned to named beneficiaries and irrevocably assigned by the decedent, held not includible in estate under I.R.C. § 811(c)(1)(B)(1939) (current version at I.R.C. § 2036 (West 1979))).

The principal issues examined in the discussion that follows are:

1. Problems in determining whether the transferor retained possession or enjoyment of the transferred property or the right to the income therefrom as required for the operation of section 2036(a)(1);¹⁰

2. The scope of the term "designate," as used in section 2036(a)(2), relating to the decedent's power to designate the persons who shall possess or enjoy the transferred property or the income therefrom;¹¹

3. The effect of contingencies, discretion, and external standards in determining whether rights retained by the decedent are reached by section 2036(a);¹²

4. The statutory criteria specifying the period of time for which an otherwise tainted power must be retained to bring section 2036 into force;¹³

5. The overlap in coverage between sections 2036 and 2038;¹⁴ and

6. Grandfather clauses covering certain pre-1933 transfers.¹⁵

II. TRANSFERS SUBJECT TO RETAINED LIFE ESTATES

Section 2036(a)(1) requires the value of transferred property to be included in the decedent's gross estate if the decedent retained for his life, for any period not ascertainable without reference to his death, or for any period that did not in fact end before his death "the possession or enjoyment of, or the right to the income from, the [transferred] property."¹⁶ The classic case in which property qualifies for inclusion under section 2036(a)(1) is that of a trust under which the income is payable to the grantor for life. The statutory reference to "the right to the income," however, covers cases in which the decedent was entitled to receive the income (e.g., on demand), but did not actually receive it. Moreover, the reference to the retention of "possession or enjoyment" of the transferred property insures that section 2036(a)(1) will reach property that does not generate income in the conventional sense, such as vacation homes and works of art, if the decedent retained the right to occupy or hold the property for the statutory period.

The remainder of this section examines the principal interpretative problems arising under section 2036(a)(1).

A. *Payment of Decedent's Debts*

Instead of retaining a life estate in property by providing that the income shall be paid to him, a transferor can get the same benefits by

10. See *infra* notes 16-49 and accompanying text.

11. See *infra* notes 50-65 and accompanying text.

12. See *infra* notes 66-82 and accompanying text.

13. See *infra* notes 83-101 and accompanying text.

14. See *infra* notes 102-07 and accompanying text.

15. See *infra* notes 108-22 and accompanying text.

16. For the legislative history of § 2036(a)(1), see *infra* text accompanying notes 109-19.

arranging to have the income from the transferred property paid over to a creditor (e.g., to amortize a mortgage on a home) or to a supplier of goods or services (e.g., to defray annual insurance premiums). Not surprisingly, therefore, the Treasury regulations provide that section 2036(a)(1) is satisfied if "the use, possession, right to the income, or other enjoyment [of the transferred property] is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit."¹⁷

This principle does not apply, however, if the benefit to the transferor is peripheral or remote. An example of this would be a gift of mortgaged rental property, the income from which is to be used to service the mortgage on transferred property, since the primary benefit inures to the donee of the property, even though the payments simultaneously reduce the donor's secondary liability on the mortgage debt.¹⁸ In the same vein, if the income from transferred property is payable to members of the transferor's family, it is not deemed to accrue to the benefit of the transferor merely because of his emotional satisfaction with the resulting improvement in their financial status.¹⁹

B. *Support of Dependents*

After providing that property is includible in the decedent's gross estate if the income was to be applied to discharge the decedent's "legal obligations," the regulations state that this term includes the decedent's obligation to support a dependent during his lifetime.²⁰ The income must be earmarked for support; the regulations do not apply if the income is merely payable to a dependent of the decedent, even if under local law the decedent's support obligation is reduced or eliminated when the dependent can draw on other resources.

Property is routinely transferred in trust for the benefit of the grantor's spouse or children, on the assumption that the grantor does not have a "right" to income payable without restrictions to the beneficiaries,²¹ and that the reference in the regulations to income that "is to be applied" to defray the decedent's legal obligations requires more than that the income "may" be so applied.²² This ration-

17. Treas. Reg. § 20.2036-1(b)(2) (1960). *See also* *Helvering v. Mercantile-Commerce Bank & Trust Co.*, 111 F.2d 224, 226 (8th Cir.), *cert. denied*, 310 U.S. 654 (1940) (trust income applied to discharge grantor's legal obligations "stands on substantially the same footing as though the settlor had received the income personally and paid it out personally").

18. *Hays' Estate v. Commissioner*, 181 F.2d 169 (5th Cir. 1950).

19. *Wishard v. United States*, 143 F.2d 704 (7th Cir. 1944).

20. Treas. Reg. § 20.2036-1(b)(2) (1960).

21. I.R.C. § 2036(a)(1) (West 1979).

22. *See* *Colonial-American Nat'l Bank v. United States*, 243 F.2d 312 (4th Cir. 1957) (trust income treated as gift to wife, not as discharge of support obligation; in claim for support or alimony, gift might be "an equitable consideration" but could not be raised "as a legal bar to the wife's claims"); *Estate of Mitchell v. Commissioner*, 55 T.C. 576 (1970), *acq.*, 1971-1 C.B. 2 (income distributable to support decedent's wife in discretion of independent trustee; § 2036(a)(1) not applicable); *Estate of Scheide*, 16 T.C.M. (P-H) ¶ 47,321 (1947) (wife's use of

ale also protects the decedent if trustees other than the grantor are authorized, but not required, to distribute trust income for the support of the decedent's legal dependents.²³

If, on the other hand, the income must be applied for the support of the decedent's legal dependents, the courts hold that a right to the income is "retained" by the decedent, bringing section 2036(a)(1) into force.²⁴ In so holding, they recognize that section 2036(a)(1) will reach only part of the transferred property, if it generates more income than will be required to defray the decedent's legal obligations.²⁵

Another qualification on the application of section 2036(a)(1) to mandatory support trusts for the decedent's minor children was added by a 1950 district court decision which held that the property of a trust of this type was not includible in the decedent's estate when the beneficiary reached the age of 21 during the decedent's life, on the theory that the decedent had no right at the date of his death to apply the income to his pecuniary benefit.²⁶ It could be argued, however, that since the income was to be applied to defray the decedent's legal obligations until he died or until the beneficiary attained the age of 21, whichever occurred first, the decedent had retained enjoyment of the trust income for a period "not ascertainable without reference to [the decedent's] death." Thus, it could be maintained that in such

income from transferred property to defray household expenses not relevant, in absence of agreement that income would be so used).

23. *Estate of Mitchell v. Commissioner*, 55 T.C. 576 (1970), *acq.* 1971-1 C.B. 2. If, however, the grantor is (or by self-appointment could become) a trustee, § 2036(a)(1) applies to income that could be used to relieve the grantor of his legal obligation of support, whether or not the income was actually, or even likely to be, so used. *See Estate of McTighe v. Commissioner*, 46 T.C.M. (P-H) ¶ 77,410 (1977) (presumption against emancipation before age 21 not rebutted by taxpayer; assets included in gross estate).

24. *See, e.g., Richards v. Commissioner*, 375 F.2d 997 (10th Cir. 1967) (trust included in gross estate where trustees were required to distribute it for support purposes, despite discretionary power to determine when to distribute; fact that decedent continued to support spouse was immaterial); *Commissioner v. Dwight's Estate*, 205 F.2d 298 (2d Cir.), *cert. denied*, 346 U.S. 871 (1953) (discussing I.R.C. § 811(c) (1939) (current version at I.R.C. § 2036 (West 1979))); *Estate of Gokey v. Commissioner*, 72 T.C. 721 (1979) (trust requirement of "support, care, welfare, and education" of decedent's dependents held not broader than support which was decedent's legal obligation); *Estate of Lee v. Commissioner*, 33 T.C. 1064, 1067 (1960) (§ 2036(a)(1) applies only if decedent has "a right to require that the income be utilized for support purposes as opposed to a permissive or discretionary power in the trustee so to apply it"; on facts, this requirement was satisfied). *See also Helfrich's Estate v. Commissioner*, 143 F.2d 43 (7th Cir. 1944) (decedent's use of trust income to defray child's college expenses admissible to establish that ambiguous trust terms sanctioned expenditures defraying decedent's legal obligations, pursuant to I.R.C. § 811(c) (current version at I.R.C. § 2036 (West 1979))); *Estate of Pardee v. Commissioner*, 49 T.C. 140, 148 (1967) (decedent's discretionary power to use trust funds for support of children controlling, even if not exercised; § 2036(a)(1) "does not require that the transferor pull the 'string' or even intend to pull the string on the transferred property; it only requires that the string exist").

25. *Estate of Pardee v. Commissioner*, 49 T.C. 140 (1967) (portion of trust burdened by support obligation determined on facts). *See also Commissioner v. Dwight's Estate*, 205 F.2d 298 (2d Cir.), *cert. denied*, 346 U.S. 871 (1953) (executor failed to prove that amount payable to decedent's spouse exceeded decedent's support obligation).

26. *Townsend v. Thompson*, 42 A.F.T.R. (P-H) 1309 (E.D. Ark. 1950).

situations the throwback provisions of section 2036(a)(1) should be applied.²⁷

C. *Gifts to Minors*

Because the Uniform Gifts to Minors Act²⁸ and the Gifts of Securities to Minors Act²⁹ vest the custodian with discretionary power to use the income from the donated property for the minor's support, the IRS has ruled that the property must be included in the gross estate of a donor who dies while acting as custodian, and the courts agree.³⁰

D. *Alimony Trusts*

As an initial proposition, it can be said that alimony trusts are ordinarily subject to section 2036(a)(1), since the income defrays the grantor's continuing legal obligation to support the ex-spouse, whether the obligation arises from local statutory law, the divorce decree, or an agreement between the parties.³¹ In some jurisdictions, however, it is possible to terminate any continuing support obligation by a settlement agreement; if this is accomplished by the creation of a trust, the subsequent distributions of trust income to the ex-spouse should not be attributed to the grantor, and this in turn should immunize the trust against the operation of section 2036(a)(1). In most jurisdictions, however, the divorce court retains jurisdiction over the parties and can increase or decrease the support payments in accordance with changing circumstances, so that an alimony trust necessarily defrays the settlor's contingent legal obligations.

For some estate and gift tax purposes, a transfer of property in exchange for a release of the transferee's right to be supported by the transferor is treated not as a donative transaction, but rather as a bona fide sale or business arrangement.³² Building on this foundation, it could be argued that the creation of an alimony trust is "a bona fide sale for an adequate and full consideration in money or money's worth" within the meaning of section 2036(a), so as to immunize the transferred property against estate tax. To succeed in this argument, however, the executor would have to establish that the released support rights (plus any other consideration received by the settlor) were equal in value to the entire amount transferred, not merely to the present value of the income stream. This burden might be satisfied in

27. See *infra* text accompanying notes 83-101.

28. Uniform Gifts to Minors Act § 4(b) (Revised 1966).

29. Model Gifts of Securities to Minors Act § 3(a) (1976).

30. See, e.g., *Estate of Prudowsky*, TAX CT. REP. DEC. (P-H) ¶ 55.90 (1971), *aff'd per curiam*, 465 F.2d 62 (7th Cir. 1972).

31. See, e.g., *Commissioner v. Dwight's Estate*, 205 F.2d 298 (2d Cir.), *cert. denied*, 346 U.S. 871 (1953) (decided under I.R.C. § 811(c) (1939), predecessor to I.R.C. § 2036).

32. See, e.g., *Puchner v. United States*, 274 F. Supp. 704 (E.D. Wisc. 1967); *Estate of O'nan*, 47 T.C. 648 (1967).

unusual circumstances, but ordinarily the best evidence of the value of the support rights is the value of the income stream for which the support rights were surrendered.³³ In this common situation, the value of the trust assets must be included in the gross estate, except to the extent of the consideration received by the settlor, i.e., the commuted value of the support rights.

E. "Retention" of Rights

Section 2036(a) applies only if the decedent "retained" possession or enjoyment of the transferred property or the right to the income therefrom for the statutory period. The requisite rights need not be explicitly "retained" by a formal agreement; an informal understanding or arrangement is sufficient.³⁴

If the decedent gave the family residence to his or her spouse or children but continued to live in it, it is not unreasonable to infer that the decedent's continued occupancy was intended from the outset, and that it did not result from the unexpected generosity of the donee. In an important case, however, the Tax Court termed the continued presence of both spouses in a home given by one spouse to the other "a natural use" growing out of "a congenial and happy family relationship" that did not diminish the donee spouse's possession and enjoyment of the property. Joint occupancy by itself did not, therefore, "indicate the existence of an agreement for retained enjoyment."³⁵

The IRS subsequently acquiesced in this decision, but in doing so it distinguished cases involving co-occupancy by the donor-spouse and the donee-spouse from cases involving transfers of a residence to a child where the donor continues to be the sole occupant of the property.³⁶ In the latter situation, the courts have inferred that the donor retains possession and enjoyment pursuant to an understanding with the donee from, *inter alia*, the donor's exclusive rent-free occupancy, the payment of utility bills and taxes by the donor, and the donee's failure to offer the property for rent or sale to others.³⁷ Moreover, the

33. See generally *United States v. Davis*, 370 U.S. 65 (1962) (absent a readily ascertainable value for wife's marital rights it is presumed they are equal in value to the property transferred by the husband).

34. *Estate of Green*, 64 T.C. 1049 (1975).

35. *Estate of Gutches v. Commissioner*, 46 T.C. 554, 557 (1966), *acq.* 1967-2 C.B. 2.

36. Rev. Rul. 70-155, 1970-1 C.B. 189. For a subsequent case applying § 2036(a)(1) to a husband-wife arrangement, see *Estate of Hendry v. Commissioner*, 62 T.C. 861 (1974) (family ranch, with residence, included in husband's gross estate despite gift to wife, where control of farm income was retained by husband).

37. See, e.g., *Guyann v. United States*, 437 F.2d 1148 (4th Cir. 1971); *Estate of Rapelje v. Commissioner*, 73 T.C. 82, 85-88 (1979), and cases cited therein; *Estate of Linderme v. Commissioner*, 52 T.C. 305 (1969) (inferring the existence of an understanding from fact that residence was kept vacant while decedent was in nursing home). See also *Estate of Stubblefield v. Commissioner*, 81 T.C.M. (P-H) ¶ 81,353 (1981) (§ 2036(a)(1) applied to cost of residence constructed by decedent on land owned by children, which decedent and spouse occupied rent-free until decedent's death). But see *Estate of Barlow v. Commissioner*, 55 T.C. 666 (1971)

IRS ruled in 1978 that section 2036(a)(1) applied to a residence given by the decedent to his son, because "it was assumed" that the decedent would continue to live there, even though the son paid the maintenance expenses and occupied the residence jointly with his spouse and the donor.³⁸ Under the ruling, the entire value of the property was taxed, presumably on the theory that the decedent reserved exclusive occupancy rights for life, so that the son and daughter-in-law were the decedent's guests. If it could be established, however, that the decedent retained only the right to occupy the property jointly with the other two, the includible amount might be only a portion of the value.

In the same vein, a gift of a vacation home to the donor's child, subject to the donor's right to occupy the property for life during the summer, would require that only a fraction of its value be included under section 2036(a)(1), if, for example, the child regularly rented the property during the off-season months and the donor and child shared the operating expenses.³⁹

F. *Community Income from Separate Property*

In some community property states, including Texas, each spouse has a community property interest in the income arising from the other spouse's separate property. Building on this aspect of Texas law, the IRS contended in several test cases that section 2036(a)(1) applied to gifts to a spouse of the donor spouse's half interest in community property, on the theory that the donor retained a one-half interest in the income from the transferred property.⁴⁰ In 1980, however, the Court of Appeals for the Fifth Circuit held that each spouse's control over separate property (described as a "special community" or "sole management community" interest) is so extensive that the other spouse's residual interest in the income cannot properly be classified as a "right to income" within the meaning of section 2036(a)(1).⁴¹ As an

(§ 2036(a)(1) not applicable to farm given by decedent to children and leased back at fair rental value; court rejected Service's claim that decedent retained possession of property and that rental payments were merely additional gifts).

For transactions involving transfers of residential property to a controlled corporation, subject to the transferor's right to use the property for less than fair rental value, followed by a gift of the corporate stock to members of the decedent's family, see *Estate of DuPont v. Commissioner*, 63 T.C. 746, 761-66 (1975) (value of property includible in decedent's estate); *Estate of Shearer v. Commissioner*, 17 T.C. 304 (1951) (value of stock includible in decedent's estate).

38. Rev. Rul. 78-409, 1978-2 C.B. 234.

39. See Rev. Rul. 79-109, 1979-1 C.B. 297 (proportionate inclusion where decedent reserved right to use or rent vacation home for one month each year).

40. See, e.g., *Commissioner v. Estate of Hinds*, 180 F.2d 930 (5th Cir. 1950).

41. *Estate of Wyly v. Commissioner*, 610 F.2d 1282, 1290 (5th Cir. 1980). This uncharacteristically modest description of community property law, even though concerned with only one aspect thereof, will astonish the dwindling band of tax lawyers who remember the way the system was described by community property enthusiasts when such cases as *Poe v. Seaborn*, 282 U.S. 101 (1930), and *Fernandez v. Weiner*, 326 U.S. 340 (1945), were argued. By a curious reversal of roles, tax theorists who used to belittle the "vested right" claims traditionally made by community property lawyers might find *Estate of Wyly* more persuasive than *Poe v. Seaborn*.

alternative ground, from which one judge dissented, the court held that the donor's community property interest in the income was not "retained" by the donor "under" the transfers, as required by section 2036(a)(1), but was instead "created solely by operation of law as the unavoidable result" of a transaction that the parties intended to be as complete a conveyance as possible.⁴²

G. Reclassified Transactions—Annuities, Installment Sales, etc.

Although the principal targets of section 2036(a)(1) are gifts of property subject to retained life estates, the statutory purpose requires its application of the section to other transactions resulting in the same quasi-testamentary shift of economic benefits from the transferor to the transferee. The line of demarcation is sometimes easily drawn, but there are also some troublesome boundary disputes.

A good starting point will be an examination of the purchase of a single premium commercial annuity contract, under which the insured will receive monthly payments for life. It is clear that this is not a transfer within the reach of section 2036(a)(1), even though the insurance company takes account of the expected return on its invested assets, including the premiums, in determining the amounts it can promise to pay to its policyholders. Section 2036 is inapplicable because the transaction does not entail a retention by the insured of the right to income from the property, since the amounts to be paid are a mixture of interest and capital, are guaranteed by the company, are not secured in any way by the premium paid, and do not vary with the income realized by the insurance company from the premium paid by the decedent. Indeed, it would be impossible to trace the premium into the company's investment portfolio. Moreover, the insured's purchase of a commercial annuity is a bona fide sale for full consideration, which has substantially the same economic effect as a retention of the premium if the insured dies at the end of his life expectancy. The insured's gross estate would not be reduced any more by the annuity payments being used to defray living expenses than it would be by investing the premium and using the resulting income and portions of the invested amount to defray the insured's living expenses. In both cases, the decedent will have nothing left at death, and nothing will be transferred to his heirs. On the other hand, if he saves and reinvests the annuity payments, the accumulation will be included in his gross estate, and the amount will be comparable to the accumulation that would have resulted from retaining and reinvesting the premium.

The foregoing analysis leads to the conclusion that section 2036(a)(1) does not, and should not, apply to the purchase of a

42. *Estate of Wyly*, 610 F.2d 1282, 1294 (5th Cir. 1980). Note, however, that the parties could have agreed that the income from the donee's separate property would not be community property.

commercial annuity. This analysis is equally applicable to a private annuity, such as an elderly person's transfer of property to a child in exchange for lifetime support or monthly payments for life, provided the financial terms are comparable to a commercial annuity. If, however, the value of the transferee's commitment is less than the value of the transferred property, the transaction has a quasi-testamentary flavor and cannot qualify as a "bona fide sale for an adequate and full consideration in money or money's worth"; if the promised support or payments are dependent on and secured by the property, there is authority for treating the arrangement as a transfer of property subject to a retained life estate.⁴³ On the other hand, section 2036(a)(1) does not apply if the promised payments are not dependent on the income produced by the transferred property, are not secured by the property itself, and constitute personal obligations of the transferee.⁴⁴ These protective factors were distilled by the Supreme Court from several pro-taxpayer decisions in this area.⁴⁵ Decisions in cases concerning intra-family arrangements give more attention to the transaction's formal characteristics than to its substance.⁴⁶

In other cases, however, the courts have been willing to recharacterize family arrangements as transfers subject to retained life estates when the facts warranted. For example, the purported sale of stock of a closely-held corporation to the decedent's children was subjected to section 2036(a)(1) because an accompanying employment contract guaranteeing the transferor an unearned "salary" for life was tantamount to the retention of an interest in the corporation's income.⁴⁷ On the other hand, a sale of property for installment payments to continue for a period of years or until the seller's death, whichever occurs first, is not subject to section 2036 if the amounts are unrelated to the income produced by the transferred property.⁴⁸ If the value of

43. See *Lazarus v. Commissioner*, 513 F.2d 824 (7th Cir. 1975) (purported sale treated as transfer with reserved life estate for income tax purposes); *Greene v. United States*, 237 F.2d 848 (7th Cir. 1956) (transfer of property to donee on latter's agreement to pay the income to donor, but not less than \$1,500 per year; held, § 811(c) (predecessor of § 2036) embraces transfer by trust "or otherwise," including this transaction); *Tips v. Bass*, 21 F.2d 460 (W.D. Tex. 1927) (same result under prior law); *Bixby v. Commissioner*, 58 T.C. 757, 791 (1972) (purported annuity payments constituted retained income interests for income tax purposes and would have been similarly treated under § 2036); Rev. Rul. 55-378, 1955-1 C.B. 447 (trust of \$100,000 created by the grantor for the benefit of his children, under which he reserved the right to withdraw \$2,500 a year or all of his living expenses, held to be includible).

44. See *Estate of Becklenberg v. Commissioner*, 273 F.2d 297 (7th Cir. 1959); *Estate of Bergan v. Commissioner*, 1 T.C. 543 (1943), *acq.* 1943 C.B. 2.

45. *Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274, 280 n.8 (1958). See also *Schwartz v. Commissioner*, 9 T.C. 229 (1947) (transferred property included in gross estate where amount actually received fluctuated with income and transferee's obligation to pay level amount was disregarded); *Estate of Fry v. Commissioner*, 9 T.C. 503 (1947) (gift of property subject to payment to transferor of first \$15,000 of dividends; § 811(c), predecessor to § 2036 applicable where stipulated amount was not paid before donor's death).

46. See *supra* note 43 and cases cited therein.

47. *Estate of Holland v. Commissioner*, 47 B.T.A. 807 (1942), *modified*, 1 T.C. 564 (1943) ("salary" for services of negligible value). But see *Estate of Hofford v. Commissioner*, 4 T.C. 790 (1945) (salary with services; *Estate of Holland v. Commissioner* distinguished).

48. *Cain v. Commissioner*, 37 T.C. 185 (1961).

present installments equals the value of the transferred property, the transaction has the same effect as selling the property for cash and using the proceeds to purchase an annuity for a fixed term or life, whichever occurs first.

H. *Contingencies, External Standards, etc.*

Instead of an unqualified life estate, the decedent may have retained a right to the income contingent on the occurrence of a specified event or on the exercise of discretion by a designated trustee. The status of these qualified rights to income is discussed below.⁴⁹

III. POWER TO DESIGNATE PERSON TO ENJOY PROPERTY OR RECEIVE INCOME THEREFROM

After taxing transfers of property where the transferor retains the right to receive the income or derive personal benefits from the property for life, section 2036(a) goes on to reach transfers where the transferor (either alone or in conjunction with any other person) has the power to designate the persons who shall possess or enjoy the property or the income therefrom. A power of this type brings the transferred property back into the decedent's gross estate under section 2036(a)(2), provided it is retained either for life, for any period not ascertainable without reference to the transferor's death, or for any period that does not in fact end before the transferor's death.⁵⁰

In enacting section 2036(a)(2), Congress failed to explain why the right to designate the recipient of income should be taxed in the same manner as a right to receive the income personally.⁵¹ The rationale may be that for very wealthy decedents the "extra" income produced by the transferred property would probably have been given away in any event or accumulated for distribution at death, and that, therefore, the right to designate the person to receive the income during the decedent's life is the most important feature of ownership, comparable to receiving the income personally and then giving it to the favored beneficiary. This theory is more plausible, of course, where the decedent can pick and choose among all of the potential objects of his bounty and is less plausible where his choice is severely constricted. The statutory language, however, does not distinguish between broad and narrow choices.

In *Industrial Trust Co. v. Commissioner*,⁵² the leading case on the scope of section 811(c), the predecessor of section 2036(a)(2), the decedent's reserved right enabled him to decide whether the income of

49. See *infra* notes 66-82 and accompanying text.

50. For a discussion of these statutory periods, see *infra* notes 66-82 and accompanying text.

51. For a discussion of the enactment of § 2036(a)(2), see *infra* notes 108-22 and accompanying text.

52. 165 F.2d 142 (1st Cir. 1947).

a trust should be paid during his lifetime to his child or be accumulated for distribution to the remaindermen. The decedent's executor argued that the decedent's choice was too constricted to constitute a right to designate the persons who would receive the income, and that "only a broad reserved power tantamount to a reserved life estate" was covered by section 811(c).⁵³ The court, one judge dissenting, disagreed:

Although [the taxpayer's] argument is persuasive, we find no warrant in the plain words of the statute for making a distinction between narrow and broad powers. The decedent literally had a power to designate who should enjoy the income. A distinction such as suggested would introduce numerous complexities into the administration and interpretation of this section. The taxpayer would have us draw a line between a power to select among people named in the instrument and a power to select among people at large. But this would allow easy avoidance of the tax by careful draftsmanship without any change in substance. It would be a relatively simple matter to put in the instrument a list of persons which would cover practically anyone that the decedent might ever wish to designate. In interpreting an unambiguous statute we should not assume that Congress has acted so as to allow such easy avoidance of tax. Nor would any distinction based on the number of persons among whom the decedent might choose be sound as a matter of judicial interpretation.⁵⁴

The decedent's choice in this case was confined to designating the child who was the primary beneficiary of the trust as the recipient of the income or accumulating the income for ultimate distribution to the remaindermen—the child's surviving issue or certain contingent remaindermen. Judge Magruder, dissenting, pointed out that the decedent could not know who the beneficiaries of any accumulated income would be and hence could not "designate" them in the conventional sense of identifying them by name.⁵⁵ The majority viewed this as irrelevant. Moreover, while the decedent in *Industrial Trust Co.* could have at least designated by name *one* prospective taker—the current income beneficiary—the logic of the decision applies to reserved powers under which the income will be distributed to two or more groups of potential beneficiaries, the members of which will not be determined during the decedent's lifetime, so that the decedent could not designate *any* beneficiary by name.

The court's refusal in *Industrial Trust Co. v. Commissioner* to distinguish between "broad" and "narrow" powers has become accepted judicial practice. In a 1970 Tax Court case, for example, section 2036(a)(2) was applied to a trust under which the grantor could distribute the income to the sole beneficiary or accumulate it for

53. *Id.* at 146.

54. *Id.* See also *United States v. O'Malley*, 383 U.S. 627 (1966) (I.R.C. § 811(c)(1)(B)(2) (1939)(current version at I.R.C. § 2036(a)(2) (West 1979)) reaches not only principal, but also accumulated income, which is "transferred" by the grantor when he exercises his retained power to distribute or accumulate it).

55. *Industrial Trust Co.*, 165 F.2d at 149 (Magruder, J. dissenting).

distribution to the beneficiary at age twenty-one or to his estate if he died before attaining that age.⁵⁶ This decision stretched the term “designate” to the breaking point by applying it to a right in the grantor to choose between (1) the income beneficiary and (2) the same person if living, but otherwise his or her testate or intestate successors. The Tax Court does not stand alone in reaching this conclusion, however.⁵⁷ Moreover, even though the term “designate” was a poor choice by the statute’s draftsmen, inclusion in the decedent’s gross estate in these cases is not unreasonable, since the decedent had the power to force the income beneficiary to wait for enjoyment. This can be a painful burden in an age of instant gratification, particularly since the benefit might then inure to the beneficiary’s estate, which is not the same thing as the beneficiary getting the accumulated income personally. Indeed, even the tax law recognizes that an individual and his or her estate are two “persons,” not one.

This sweeping construction of section 2036(a)(2) may seem innocuous, given the long-established interpretation of section 2038, which reaches virtually all reserved powers to alter or amend the enjoyment of transferred property, no matter how limited the decedent’s choice may be. There is, however, a fundamental difference between the two provisions—when section 2036(a)(2) applies, the value of the transferred property is included in the decedent’s gross estate, whereas section 2038 reaches only the value of the interests, the enjoyment of which can be affected by an exercise of the power. Thus, if A creates a trust under which the income is payable to X for life, remainder to Y or his estate, and A reserves the power to accumulate the income and add it to the corpus, A’s power to determine whether the income will go to X or to Y (or his estate) is a power to “designate” under section 2036(a)(2), requiring the value of the entire trust to be included in A’s gross estate. If, however, the trust is tested under section 2038, the includible amount would be limited to the value, at A’s death, of the income stream for the remainder of X’s life, since that is the only “interest” in the transferred property that can be affected by an exercise of A’s power.

Sections 2036(a)(2) and 2038 frequently overlap, as in the foregoing example; when this happens, they may or may not lead to different results, as is explained below.⁵⁸ If they diverge, the IRS quite natu-

56. *Estate of O'Connor v. Commissioner*, 54 T.C. 969 (1970).

57. *See Estate of Rott v. Commissioner*, 321 F. Supp. 654, 655 (E.D. Mo. 1971) (“[b]y accumulating income, the decedent could determine whether the [income] beneficiaries, their estates, or such persons as the beneficiaries had appointed by will would possess or enjoy the property or the income from the property”); *Struthers v. Kelm*, 218 F.2d 810 (8th Cir. 1955) (same conclusion reached as in *Rott*); *see also Joy v. United States*, 404 F.2d 419 (6th Cir. 1968) (power to accumulate income taxable where accumulated income and corpus would be paid on termination to income beneficiary if living, otherwise to contingent beneficiaries).

58. *See infra* notes 102-07 and accompanying text.

rally relies on the provision—ordinarily it is section 2036(a)(2)—that produces the larger gross estate.

There are several other ways in which the grantor can reserve certain discretionary powers to himself or to others so as to bring the provisions of section 2036(a)(2) into effect:

(a) *Indirect effect on income.* A reserved power can be reached by section 2036(a)(2) even though it does not explicitly refer to the “income” from transferred property. For example, if the grantor of a trust can distribute corpus to the income beneficiary, he has a right to designate the person who will possess or enjoy the property; this is enough to bring section 2036(a)(2) into play. It could also be argued, however, that the same power necessarily includes the right to designate the persons who will enjoy the *income* from the distributed property by insuring that the income beneficiary will get that income in perpetuity, rather than only for life. Of course, if the amount of corpus that can be distributed is limited to a fraction of the underlying property or to a specified dollar amount, the amount includible in the gross estate is similarly limited.⁵⁹

The most notable aspect of section 2036(a)(2) is the gradual recognition by the IRS and the courts that virtually all reserved powers to alter, amend, revoke, or terminate the enjoyment of transferred property—the traditional targets of section 2038—can also be viewed as rights to “designate” the persons who shall possess or enjoy the property or receive the income therefrom. If this statutory overlap always resulted in the same tax liability, it would be no more serious than a duplication of statutory effort, a common phenomenon in the Internal Revenue Code. As explained below, however, the amount includible in the gross estate may depend on whether a particular power is tested under section 2036(a)(2) or under section 2038.⁶⁰

(b) *Power as trustee.* Unlike section 2038(a), section 2036(a)(2) does not explicitly provide that a reserved power is fatal “in whatever capacity exercisable.”⁶¹ Despite this disparity in language, it is well established that section 2036(a)(2) is not limited to non-fiduciary powers, but also reaches powers exercisable by the decedent as trustee.⁶²

(c) *Joint and third party powers.* A right to designate the persons who shall possess or enjoy the transferred property or the income therefrom is covered by section 2036(a)(2) whether it is vested solely in the decedent or jointly in the decedent and one or more other persons.

59. Treas. Reg. § 20.2036-1(a) (1960) (penultimate sentence); *see also* Estate of Tomec v. Commissioner, 40 T.C. 134, 140 (1963) (computation of amount includible where decedent's power did not affect first \$10,000 of annual trust income).

60. *See infra* notes 102-07 and accompanying text.

61. *See* Treas. Reg. § 20.2036-1(a)(2) (1960).

62. Treas. Reg. § 20.2036-1(b)(3) (1960); *see also* Estate of Yawkey v. Commissioner, 12 T.C. 1164, 1172 (1949).

In the latter situation, section 2036(a)(2) applies even if the others could outvote the decedent and had interests in the transferred property that would be adversely affected by acquiescing in action desired by the decedent.⁶³ On the other hand, section 2036(a)(2) does not apply to powers held solely by persons other than the decedent. This immunity is lost, however, if the decedent reserves the unrestricted power to remove a person holding the power and appoint himself as successor.⁶⁴ It may also be lost where the decedent can (1) remove trustees at will until he finds one who is complaisant, even though he cannot appoint himself, or (2) appoint himself when a vacancy occurs, even though he cannot create vacancies by removing trustees at will.⁶⁵

IV. EFFECT OF CONTINGENCIES, DISCRETION, AND EXTERNAL STANDARDS

Section 2036(a)(1) refers to a "right" retained by the decedent to receive the income from transferred property; section 2036(a)(2) similarly refers to a "right" to designate the persons who shall possess, enjoy, or receive the income from the property. Neither provision, however, indicates whether a right is covered if dependent on a contingency or on a trustee's exercise of discretion, nor does either provision indicate whether there is a difference between discretion that is relatively untrammelled and discretion that is subject to a judicially enforceable external standard. There is, however, a large body of case law and administrative rulings on these matters, which are summarized below.

A. Contingent Rights

The regulations state flatly that a right to designate is subject to section 2036(a)(2) even if "exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's lifetime)."⁶⁶ It follows a fortiori that the power would be covered if the contingency was within the decedent's control (e.g., marriage) or if the event in fact occurred during the decedent's lifetime.

The validity of this Treasury regulation was upheld by the Court of Claims in *Estate of Farrell v. Commissioner*.⁶⁷ That case involved a

63. See *Estate of Yawkey v. Commissioner*, 12 T.C. 1164 (1949) (decedent was one of three trustees); Treas. Reg. § 20.2036-1(b)(3)(1960) (adverse interests immaterial).

64. Treas. Reg. § 20.2036-1(b)(3)(1960).

65. See Rev. Rul. 79-353, 1979-2 C.B. 325 (removal of corporate trustee); Rev. Rul. 73-21, 1973-1 C.B. 405 (decedent's power to appoint himself when vacancy occurs); see also *Estate of Gilchrist v. Commissioner*, 630 F.2d 340 (5th Cir. 1980) (incompetent's power to designate herself as successor trustee, if reserved, would devolve upon decedent's guardian under local law; case remanded to Tax Court to determine whether such a power was actually reserved).

66. Treas. Reg. § 20.2036-1(b)(3)(1960).

67. *Estate of Farrell v. Commissioner*, 553 F.2d 637 (Ct. Cl. 1977).

trust whose trustees had broad powers to distribute the net income or principal to the beneficiaries—powers constituting a tainted right to designate under section 2036(a)(2) if retained by the decedent.⁶⁸ The decedent retained the right to name herself as successor trustee if a vacancy occurred by reason of a trustee's death, resignation, or removal. Although there was no vacancy during the grantor's life, the court held that section 2036(a)(2) applied because the grantor could have appointed herself if the specified contingency had occurred: "[I]t is not unreasonable to regard 2036(a), in the way the Treasury does, as a blanket overall sweeping-in of property over which the decedent still has at death some significant, though contingent, power to choose those who shall have possession or enjoyment."⁶⁹ In so holding, the court noted that contingent powers to alter, amend, revoke, or terminate a trust are not reached by section 2038 if the event is not subject to the decedent's control and does not occur during his lifetime. Section 2038 applies only if enjoyment of the property is subject at the date of the decedent's death to change through an exercise of the power. By contrast, section 2036(a) is satisfied if a right to designate is "retained" for life.⁷⁰

The Treasury regulation quoted in the preceding paragraph applies by its terms only to section 2036(a)(2), but this should not be construed to exempt contingent powers from the operation of section 2036(a)(1). The right to get the income personally necessarily includes the lesser right to designate the recipients of the income. If a contingent right to do the latter is covered by section 2036(a)(2), a contingent right to get the income personally is, if anything, a fortiori included under section 2036(a)(1). Moreover, the Court of Appeals for the Second Circuit has twice held that a retained secondary estate is subject to section 2036(a)(1) even if the stipulated contingency—death of the primary life tenant during the decedent's lifetime—did not occur.⁷¹

B. *Discretion Versus External Standards in General*

In determining whether the decedent retained a "right" within the meaning of section 2036(a)(1), or section 2036(a)(2) where distributions of income are subject to the discretion of a trustee, the courts distinguish between discretion that must be exercised pursuant to a judicially enforceable external standard, such as a power to distribute

68. See Rev. Rul. 73-21, 1973-1 C.B. 405.

69. 553 F.2d 637, 642 (Ct. Cl. 1977).

70. See Treas. Reg. § 20.2036-1(a)(1960).

71. *Commissioner v. Estate of Arents*, 297 F.2d 894 (2d Cir.), cert. denied, 369 U.S. 848 (1962) (reaffirming *Marks v. Higgins*, 213 F.2d 884 (2d Cir. 1954), despite the contrary view expressed in *Estate of Hubbard v. Commissioner*, 250 F.2d 492 (5th Cir. 1957)). Note, however, that the date-of-death value of the primary life tenant's right to the income for the rest of his or her life is excluded from the gross estate. See Treas. Reg. § 20.2036-1(b)(ii)(1960).

income to defray extraordinary medical expenses, and discretion that is relatively untrammelled, such as a power to distribute income when the trustee deems it in the best interests of the beneficiary.⁷² The same distinction is drawn by the courts in applying section 2038.⁷³

The actual tax effect of a trustee's discretion over the distribution of income depends on whether the issue arises under section 2036(a)(1) or under section 2036(a)(2), as explained below.

C. *External Standards under Section 2036(a)(1)*

If the transferor of property does not have an unqualified life estate, but only a right to receive the income if the trustee so decides, section 2036(a)(1) applies to amounts that the trustee can be compelled to distribute,⁷⁴ but not to amounts over which the trustee has untrammelled discretion.⁷⁵ The immunity of amounts subject to the trustee's absolute discretion, however, presupposes that the decedent is not the trustee and cannot freely substitute himself for the designated trustee.⁷⁶

D. *External Standards under Section 2036(a)(2)*

An external standard governing a trustee's exercise of discretion has a very different tax impact under section 2036(a)(2) than under section 2036(a)(1). Since the issue under section 2036(a)(2) is whether a discretionary power *retained by the decedent* over distributions of income constitutes a "right" to designate the persons who will get the income, the income-producing property must be included in the decedent's gross estate if his discretion was uncontrolled, but not if the discretion can be exercised only in accordance with a judicially enforceable external standard. By contrast, as explained above, a decedent has a "right" to the income under section 2036(a)(1) if a *third-party trustee* is compelled by an external standard to distribute the income to the decedent, but not if the trustee's discretion is absolute.

72. See, e.g., *Armata v. United States*, 494 F.2d 1371 (Ct. Cl. 1974).

73. See, e.g., *Estate of Hays v. Commissioner*, 181 F.2d 169 (5th Cir. 1950); *Jennings v. Smith*, 161 F.2d 74 (6th Cir. 1947); *Estate of Frew*, 8 T.C. 1240 (1947); *Estate of Budlong*, 7 T.C. 756 (1946), *rev'd on other grounds*, 165 F.2d 142 (1st Cir. 1947). All of these cases discuss I.R.C. § 811(d), the predecessor of § 2038.

74. See *Estate of Boardman v. Commissioner*, 20 T.C. 871 (1953) (language of instrument construed to deny trustees power to withhold any income that grantor might have desired during her life); *Estate of Rosenwasser v. Commissioner*, 5 T.C. 1043 (1945) (prior law), and cases cited therein.

75. See *Estate of Chrysler v. Commissioner*, 44 T.C. 55, 60-62 (1965), *rev'd on other grounds*, 361 F.2d 508 (2d Cir. 1966) (no right retained by decedent to compel trustees to exercise discretionary power over trust income to discharge decedent's support obligations); *Estate of Skinner v. United States*, 316 F.2d 517 (3d Cir. 1963) (facts justified inference of secret understanding that, ostensibly, absolute discretion would be exercised in grantor's favor).

76. For a discussion of imputation to the decedent of a trustee's powers if the decedent can remove the trustee and substitute himself, see *Estate of Edmonds v. Commissioner*, 72 T.C. 970, 984-85 (1979).

Thus, the Tax Court has held that a power retained by the decedent as trustee to invade the corpus of a trust (and thereby to shift possession and enjoyment thereof to the distributee) in order to defray expenses caused by a beneficiary's "illness, infirmity or disability, either mental or physical" is not a "right" within the meaning of section 2036(a)(2), because the decedent does not have a free hand, but must instead act in accordance with a judicially enforceable external standard.⁷⁷ On the other hand, a power to distribute income to the extent that the grantor-trustee "may deem necessary for the [beneficiary's] benefit" was held by the Tax Court to be so broad that its exercise was not limited "by any ascertainable standard," with the result that it constituted a retained "right" within the meaning of section 2036(a)(2).⁷⁸

In the same vein, the decedent's retention of administrative powers, such as the right to allocate receipts and expenditures between income and principal, is not a "right" to designate the recipients of the income within the meaning of section 2036(a)(2) if the power must be exercised, as is ordinarily the case, in accordance with equitable principles that are judicially enforceable.⁷⁹ In theory, untrammelled discretion is fatal in this area, but in practice the courts usually conclude that a decedent-trustee's administrative powers are subject to judicial supervision even if the instrument purports to vest him with virtually absolute discretion.⁸⁰

In *Jennings v. Smith*,⁸¹ the court suggested that a power exercisable only in accordance with an external standard could be viewed as a contingent power, exercisable only if the prescribed event occurs. If accepted, this theory would lead to the same result under section 2038 as the external standard rationale. If adopted and applied to section 2036(a)(2), however, it would not buttress the external standard doctrine, but would conflict with it, since section 2036(a)(2), unlike section 2038, reaches contingent powers even if the specified event does not occur during the decedent's lifetime.⁸² The issue has not been explored in the litigated cases, and the external standard doctrine is by now so well-entrenched in the application of section 2036(a)(2) that the "contingency" alternative may well have no future.

77. *Estate of Ford v. Commissioner*, 53 T.C. 114, 125-27 (1969). The grantor-trustee in *Estate of Ford* could also invade corpus to provide for the beneficiary's "support, maintenance, education, welfare, and happiness"; a majority of the court held that this language imposed an enforceable external standard, despite use of the broad term "happiness." Five judges dissented from this part of the decision.

78. *Estate of Cutter v. Commissioner*, 62 T.C. 351 (1974).

79. See *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970); *Estate of Ford v. Commissioner*, 53 T.C. 114, 127-29 (1969), and cases cited therein.

80. *Old Colony Trust Co. v. United States*, 423 F.2d 601 (1st Cir. 1970).

81. 161 F.2d 74 (2d Cir. 1947).

82. Compare Treas. Reg. § 20.2036-1(b)(3)(1960) (occurrence of contingency irrelevant) with Treas. Reg. § 20.2038-1(b)(1962) (non-occurrence of contingency renders § 2038 inapplicable).

V. RETENTION FOR LIFE OR EQUIVALENT PERIOD

The primary target of section 2036 is a gift of property subject to a retained life estate. If the provision were to apply only where the decedent retained the right to receive the income for his entire life, however, it could be easily avoided—by making the income for the year of the donor's death payable to a different beneficiary, for example. To frustrate tax avoidance schemes of this type, section 2036(a) requires the transferred property to be included in the gross estate if the decedent retained the right to the income or the right to designate the income beneficiary for any of three periods of time defined in the statute: for the transferor's remaining life; for more than that period ("life plus"); or for less than that period ("life minus"). Moreover, while the right to the income must be retained when the transfer is made (rather than acquired at a later time), it need not encompass all income earned from the date of the transfer, but can instead start with the income arising after a prescribed later date.

A. *Reservations of Income for Life*

Since its enactment in 1931, section 2036(a) has applied to any transfer under which the decedent "retained for his life" the right to the income or the right to designate the income beneficiary of the transferred property.⁸³ The intended end point of this period is obviously the transferor's death. The statutory language does not indicate, however, whether the transferor's right to the income is "retained for his life" if it is subject to a delayed effective date, or only if it covers the income from the date of the transfer until the date of the transferor's death. For example, would the income right be retained for life if the transferor were not entitled to receive the income until five years after the transfer or until a specified person dies, and then, assuming the transferor's survival on the prescribed effective date, the transferor receives the income from then until death? As explained below, this ambiguity in the phrase "retained for [the transferor's] life" need not be resolved, because transfers with delayed effective dates are included in one or both of the other two time periods described by section 2036.

B. *Reservations of Income for Life Plus*

In addition to reaching transfers subject to retained life estates, section 2036(a) applies to transfers under which the transferor retains "for any period which does not in fact end before his death" the right to receive income or the right to designate the income beneficiary. In recommending enactment of this part of section 2036(a), the House Ways and Means Committee gave as an example of its intended

83. For the legislative history of I.R.C. § 2036(a), see *infra* text accompanying notes 108-22.

coverage "a transfer where decedent, 70 years old, reserved the income for an extended term of years and dies during the term."⁸⁴ This example focuses on a term of years that the transferor expects to cover his remaining lifetime. The provision is not limited to tax avoidance transactions, however. It has been applied to a transfer under which the income was to be used to defray the transferor's legal support obligations until the remarriage or death of his divorced wife. The transferor died without either of those events having occurred, and the provision was held applicable, even if the transferor had not intended the retained right to last until his death.⁸⁵ The same result was reached in a case involving a transfer of stock subject to a reservation of the first \$15,000 of dividends.⁸⁶

These cases suggest that section 2036(a) applies no matter how short the reserved term or unexpected the death. For example, unless the courts are willing to carve out a de minimis exception, the provision would reach a grantor who created an irrevocable trust the income from which was to be applied to defray his household bills while he was away on a three-month round-the-world cruise, where the grantor was killed an hour after creating the trust.⁸⁷ This death-while-entitled-to-income rule also reaches a transfer reserving the income for life, commencing with a delayed effective date (e.g., the fifth anniversary of the transfer or the death of the primary life tenant), if the transferor dies after the prescribed event occurs.

C. Reservations of Income for Life Minus

The third period covered by section 2036(a) is "any period not ascertainable without reference to [the transferor's] death." This language, enacted in 1932, is designed to reach tax avoidance devices, such as reservations of income except for amounts attributable to the calendar year of the transferor's death.⁸⁸ While the courts might have treated transfers of this type as tantamount to reserve life estates despite the exclusion of the final year,⁸⁹ the legislative history elimi-

84. H. R. REP. NO. 708, 72d Cong., 1st Sess. (1932), *reprinted in* 1939-1 C.B. 457, 490-91. *See also* Estate of Nicol v. Commissioner, 56 T.C. 179 (1971) (five year reservation by 77-year old transferor).

85. Estate of McKeon v. Commissioner, 25 T.C. 697, 704 (1956), *acq.* 1958-2 C.B. 7; *see also* National Bank of Commerce v. Henslee, 179 F. Supp. 346, 352 (M.D. Tenn. 1959) (same result under pre-1954 regulations providing that reservation must be "for such a period as to evidence [the transferor's] intention that it should extend at least for the duration of his life"); Estate of Yawkey v. Commissioner, 12 T.C. 1164 (1949), *acq.* 1949-2 C.B. 3 (control over income until granddaughters attained age 25).

86. Estate of Fry v. Commissioner, 9 T.C. 503 (1947).

87. If § 2036 does not apply and if the right to receive the income for the remainder of the three-month period did not terminate on death, its date-of-death value should be includible in the transferor's gross estate under § 2033.

88. *See* Treas. Reg. § 20.2036-1(b)(i)(1960). *See also* H. R. REP. NO. 708, 72d Cong., 1st Sess. (1932), *reprinted in* 1939-1 C.B. 457, 490.

89. *See* Bayliss v. United States, 326 F.2d 458 (4th Cir. 1964) (exclusion of income for calendar quarter preceding transferor's death did not protect transfer against tax, even though

nates any debate about the issue, since it states specifically that section 2036 applies “where [the transferor] reserves the income, not necessarily for the remainder of his life, but for a period in the ascertainment of which the date of his death was a necessary element.”⁹⁰

This condition is satisfied not only if the reserved right to income is subject to a formal interruption before death (like a three-month hiatus), but also if the income is reserved for a period that will end either when the transferor dies or upon some other event (e.g., a child's death), whichever occurs first (or later). It is also satisfied if the right to income is reserved for a period that begins on a prescribed date, but only if the transferor is then living. An example of this is a reserved secondary life estate to begin if, but only if, the transferor survives the primary life tenant. Moreover, it does not matter whether the decedent survived the alternative terminal date, ever actually received any income, or could ever have exercised the reserved right to designate the income beneficiary. For example, if the transferor reserved a secondary life estate in transferred property, it is includible in his gross estate under section 2036(a)(1) even if he predeceased the primary life tenant.⁹¹ The same result would be reached under section 2036(a)(2) if the decedent reserved not a secondary life estate but the right to designate the income beneficiary following the primary life tenant's death.

D. *Point of View—Prospective or Retrospective?*

Section 2036(a) applies to transfers “under which [the decedent] retained”⁹² the right to the income (or the right to appoint the income) for any of the three statutory periods described above. Section 2038, by contrast, refers to situations in which the enjoyment of transferred property “was subject *at the date of [the decedent's] death* to any change through the exercise of a power.”⁹³

This divergence between the two provisions often leads to the assumption that the application of section 2036(a) is determined wholly by reference to the circumstances at the time the transfer occurs, whereas section 2038 focuses on the decedent's powers at, or immediately before, death.⁹⁴ This distinction is valid for some purposes: for

transfer was made before June 7, 1932, when “not ascertainable” clause was added to statutory predecessor of § 2036; right to income was tantamount to reserved life estate). *See also* I.R.C. § 2038(b) (1967) (involving similar formal limitations on reserved powers).

90. H.R. REP. No. 708, 72d Cong., 1st Sess. (1932), *reprinted in* 1939-1 C.B. 457, 490.

91. *See* Estate of Arents v. Commissioner, 297 F.2d 894 (2d Cir.), *cert. denied*, 369 U.S. 848 (1962); Marks v. Higgins, 213 F.2d 884 (2d Cir. 1954). *But see* Estate of Hubbard v. Commissioner, 250 F.2d 492 (5th Cir. 1957).

92. I.R.C. § 2036(a) (West 1979) (emphasis added).

93. *Id.* § 2038 (emphasis added).

94. *See generally* Estate of Farrel v. Commissioner, 553 F.2d 637, 640 (Ct. Cl. 1977) (provisions “appear to diverge sharply in their perspective—the point from which the pertinent powers and rights are to be seen”).

example, section 2036(a) does not apply to powers that were acquired by the decedent after the transfer rather than "retained" when it occurred, while section 2038 can apply to both retained and after-acquired powers.⁹⁵ Section 2036(a), however, is not wholly oblivious to events occurring after the transfer. Thus, if the decedent transferred property subject to a life estate but later relinquished it, section 2036(a)(1) would not apply,⁹⁶ even though at the time of the transfer it would be entirely accurate to say that the decedent "retained" the right to the income "for life." The relinquishment is taken into account not because the statutory term "retained" necessarily means "retained from the date of the transfer until the date of death," but because the transfer of property during life—even though effected in two or more steps—has long been recognized as being subject to the gift tax, unless the final step was taken in contemplation of death or within three years of death.⁹⁷

If, however, the decedent did not take any action after the transfer to alter or relinquish the retained right, selection of the proper vantage point for determining whether it was retained for one of the statutory periods could be more complicated. The issue is simple enough in the classic case of a life estate, since the right to the income is retained for life whether the decedent's rights are tested prospectively on the date of the transfer or retrospectively on the date of death. If, however, the question is whether the decedent retained a right to the income "for any period which does not in fact end before his death," a retrospective view is unavoidable, since at the time of the transfer, the transferor knows the duration of the period (e.g., "twenty years," "until X dies"), but not whether the period will terminate before the decedent's death.

We turn now to the vantage point from which one must decide whether the decedent retained a right to the income (or the right to designate the income beneficiary) "for any period not ascertainable without reference to his death." Where there is a reservation of income except for the amount generated by the transferred property between the last semiannual payment to the transferor and his death, the period is "not ascertainable without reference to [the decedent's] death" whether the arrangement is tested on the date of the transfer or on the date of the decedent's death.⁹⁸

95. See I.R.C. § 2038(a)(1)(1976) (reference to powers of decedent without regard to when or from what source the decedent acquired such powers).

96. See *Estate of Cuddihy v. Commissioner*, 32 T.C. 1171, 1177 (1959) (retained right to trust income relinquished during decedent's life). See also *Estate of Ware v. Commissioner*, 55 T.C. 69, 75 (1970) (principle recognized, but not applied, because decedent's action was ineffective under local law). For the result under prior law if an otherwise taxable interest was relinquished in contemplation of death, see Rev. Rul. 56-324, 1956-2 C.B. 999. See also *United States v. Allen*, 293 F.2d 916 (10th Cir.), cert. denied, 368 U.S. 944 (1961) (sale of life estate for inadequate consideration).

97. I.R.C. § 2035(b) (West Supp. 1982).

98. H.R. REP. NO. 708, 72d Cong., 1st Sess. (1932), reprinted in 1939-1 C.B. 457, 490.

This type of formal gap in the decedent's right to the income, however, does not exhaust the possibilities in the statutory language. If the decedent retains the right to the income from the date of the transfer to a second specified date or his death, whichever occurs first, the period is also one "in the ascertainment of which the date of [the decedent's] death was a necessary element."⁹⁹ If the decedent should die first, the reserved right, viewed in retrospect, would also qualify as a period "which does not in fact end before [the decedent's] death." Since this criterion (enacted in 1931) is satisfied, it is not necessary to test it under the "not ascertainable" criterion, which was enacted in 1932.¹⁰⁰ If, however, the decedent's right to the income terminated *before* his death, it would become necessary to decide whether the period meets the 1932 "not ascertainable" criterion, since this is the only possible ground for including the property in the gross estate under section 2036(a).

The statutory language can be construed either way, and there is some authority for the proposition that section 2036(a) is inapplicable if the reserved right to the income in fact terminated during the decedent's lifetime.¹⁰¹ On the other hand, viewed prospectively, the reference to the decedent's death was an indispensable part of the original arrangement. Although it turned out to be unnecessary, this was not because of any voluntary action by the decedent. The arrangement, therefore, had a quasi-testamentary quality that the decedent never repudiated. Therefore, the case for inclusion is quite strong, even if it is not completely compelling.

VI. OVERLAP BETWEEN SECTION 2036 AND SECTION 2038

As explained earlier, a reserved right to designate the persons who shall receive the income from transferred property is taxable under section 2036(a)(2), but it is also tantamount to a power to alter or amend enjoyment of the property, and hence may be subject to section 2038. Conversely, reserved powers to alter, amend, revoke or terminate, though covered by section 2038, virtually always enable the transferor to designate the persons who will receive the income from the affected property, and hence can be reached by section 2036(a)(2) as well. When a transfer is subject to both provisions, however, the amount includible in the gross estate is not necessarily the same. There are also circumstances in which the decedent's reserved right is subject to only one of these provisions, not to both. The major consequences of this partial overlap are examined below.

A. *Sole Jurisdiction in Section 2036(a)*

The principal target of section 2036(a)—a transfer subject to a reserved life estate—is also the principal example of a transfer that is

99. *Id.*

100. For this legislative chronology, see *infra* text accompanying notes 108-22.

101. See *Townsend v. Thompson*, 42 A.F.T.R. (P-H) 1309 (E.D. Ark. 1950).

subject to section 2036(a) but not to section 2038. The transferor's reserved right to possess, enjoy, or get the income from the transferred property is more powerful than—but it is not identical to—a power to alter, amend, revoke or terminate enjoyment of the property. Even if it were so viewed, however, the former reserved right evaporates when the transferor dies, and hence does not affect at that time any interests that could be valued and taxed under section 2038.

Section 2036(a) also reigns in solitary splendor where the decedent reserved the right to designate the beneficiary of the income from transferred property, contingent on an event beyond the decedent's control that did not occur (e.g., the death of another person during the decedent's lifetime). Under the regulations, such a contingent power is not subject to section 2038.¹⁰²

B. *Sole Jurisdiction in Section 2038*

Section 2038 can claim sole jurisdiction over powers to alter, amend, revoke and terminate enjoyment of transferred property if the power cannot affect any income during the transferor's life—for example, a trust to pay the income to A or A's estate for the grantor's life, remainder to B and C equally unless the grantor provides otherwise by will. The property is includible in the grantor's gross estate under section 2038 because of the reserved testamentary power to alter the remaindermen's enjoyment, but since this power does not affect the income during the grantor's lifetime, it is not a right to designate the persons who shall receive the income within the meaning of section 2036(a)(2).¹⁰³

Although the language of section 2036(a)(2) does not explicitly impose this "lifetime income" restriction, it is enunciated by the regulations,¹⁰⁴ and is supported by the paramount purpose of section 2036—reaching transfers subject to a reserved life estate. Since section 2036(a)(2) is only a buttress to this objective, the construction of it adopted by the regulations,¹⁰⁵ confining it to the income generated by the transferred property during the transferor's life, is reasonable and can find some support in the provision's legislative history.¹⁰⁶ Put

102. Compare Treas. Reg. § 20.2036-1(b)(3)(iii)(1960) with *id.* § 20.2038-1(b) (last two sentences).

103. Treas. Reg. § 20.2036-1(b)(3)(1960).

104. *Id.*

105. *Id.*

106. H.R. REP. NO. 1412, 81st Cong., 1st Sess. (1949); reprinted in 1949-2 C.B. 295, 300 (statutory predecessor of § 2036(a)(1) and (a)(2) does not reach "powers over the transferred property itself not affecting the enjoyment of the income during the decedent's life"). If the decedent's estate is entitled to receive post-mortem income for a period of time (because, for example, the decedent retained the right to the income for a 10-year term and died before its expiration), the date-of-death value of this right is includible in the gross estate under § 2033. This, however, is a far less drastic result than including the entire value of the underlying property in the gross estate under § 2036(a)(1).

another way, the regulations provide that section 2036(a)(2) applies to income that the decedent could appoint ("designate") only if a retained right to receive the same income would have brought section 2036(a)(1) into play.

A more specialized situation to which section 2038 applies but section 2036(a) does not, is a power to amend that is not retained by the transferor when the transfer is made, but is acquired at a later time—for example, by accepting a judicial appointment as successor trustee to fill a vacancy. Since section 2036 applies only to rights "retained" under the transfer, it does not apply to this situation, even if the grantor, on assuming the post of trustee, can thereafter designate the persons who will receive the income.

C. *Dual Jurisdiction—Same Amount Includible*

A right retained by the transferor to designate the persons who shall receive the income from transferred property is equivalent to a power to alter or amend enjoyment of the property, and hence it is reached by both sections 2036(a)(2) and 2038. A power to accumulate the income, to distribute all of the corpus, or to terminate a trust necessarily enables the transferor to designate the persons who will receive the income and hence is similarly subject to both provisions. Since these powers affect all of the income from the transferred property, the entire amount is includible under section 2036(a)(2); since they enable the transferor to alter enjoyment of all of the property, the same amount is includible under section 2038. It is immaterial, therefore, whether the IRS relies on one provision or the other.

D. *Dual Jurisdiction—Different Amounts Includible*

A simple example of a transfer that is subject to both sections 2036 and 2038, but with different results, is a trust under which the income is payable to A and B equally for their joint lives, remainder to C, subject to a reserved right to alter the relative fractional interests of A and B in the income during the grantor's lifetime or by will. If the grantor predeceases A and B, the trust assets are includible in full in the grantor's estate under section 2036(a)(2) because of the retained right to designate whether A or B would get the income. If tested solely under section 2038, however, the includible amount would be limited to the value, at the grantor's death, of the remaining life estates in A and B, since the decedent's reserved power to alter enjoyment could affect only these interests. The IRS, obviously, will rely on section 2036(a)(2) whenever it will result in a larger inclusion.

It is difficult to envision a single power that will result in a larger inclusion under section 2038 than under section 2036(a). A transfer reserving two tainted powers, however, can easily have this effect—for example, a trust to pay the income to A for life, then to the grantor

for life, and then equally to two remaindermen, with a reserved testamentary power to terminate the trust and transfer the assets to either or both of the remaindermen. If the grantor predeceases A, the amount included under section 2036(a)(1) by virtue of the reserved secondary life estate is not the entire value of the trust, but that amount less the value of A's continuing interest in the income.¹⁰⁷ By contrast, the reserved testamentary power to amend affects enjoyment of the entire property, requiring that its full value be included in the gross estate under section 2038.

VII. PRE-1933 TRANSFERS

The rules of inclusion in section 2036 do not apply to transfers before March 4, 1931 or transfers between March 3, 1931 and June 7, 1932, unless they would have been includible in the decedent's gross estate under the amendatory language of the joint resolution of March 3, 1931.¹⁰⁸ These exemptions are obviously of dwindling importance, but a brief historical note is in order to explain their scope.

From 1916 until 1930, it was widely believed that transfers subject to reserved life estates were includible in the transferor's gross estate under a statutory provision covering "transfers intended to take effect in possession or enjoyment at or after [the transferor's] death."¹⁰⁹ In 1930, however, the Supreme Court held in *May v. Heiner*¹¹⁰ that this language did not reach a transfer subject to a reserved secondary life estate, to commence on the death of the primary life tenant (the transferor's wife). On March 2, 1931, the Supreme Court held that a reserved primary life estate was also beyond the reach of the pre-1931 statute.¹¹¹ Congress, which was about to adjourn, responded to the 1931 decision with unprecedented speed. Using a joint resolution as the vehicle rather than the normal legislative process,¹¹² one day sufficed for unanimous action by both houses of Congress and for the President's signature.

This joint resolution provided for the inclusion in the gross estate of transferred property if the transferor retained for his life or any period not ending before his death (1) the possession or enjoyment of, or the income from, the property, or (2) the right to designate the persons who should possess or enjoy the property or the income therefrom.¹¹³

107. Cf. Treas. Reg. § 20.2036-1(b)(1)(ii)(1960).

108. See H.R.J. Res. 529, 71st Cong., 3d Sess., 74 CONG. REC. 7198 (1931).

109. See generally Leighton, *Origin of the Phrase, "Intended to Take Effect in Possession or Enjoyment At Or After . . . Death,"* 56 YALE L.J. 176 (1946) (discussing I.R.C. § 811(c) (1939)) (current version at I.R.C. § 2036 (West 1979)).

110. 281 U.S. 238 (1930) (secondary life estate).

111. *Burnet v. Northern Trust Co.*, 283 U.S. 782 (1931), *aff'g.* 41 F.2d 732 (7th Cir. 1930) (primary life estate). See generally Eisenstein, *Estate Taxes and the Higher Learning of the Supreme Court*, 3 TAX L. REV. 395, 445-49 (1948).

112. H.R.J. Res. 529, 71st Cong., 3d Sess., 74 CONG. REC. 7198 (1931).

113. See generally *Helvering v. Ballard*, 303 U.S. 297 (1938) (joint resolution held constitutional); *Hassett v. Welch*, 303 U.S. 303 (1938) (joint resolution intended to be prospective only).

In 1932, this provision was amended so as to give it the form now found in section 2036(a). Two of the 1932 amendments, described as "clarifying" changes by the House Committee on Ways and Means,¹¹⁴ were: (1) insertion of the words "the right to the income" in place of the words "the income," to insure coverage if the transferor was entitled to the income but did not actually receive it; and (2) insertion of the words "for any period which does not in fact end before his death," in place of the 1931 reference to a period "not ending before his death," presumably to insure that the facts, not the language used to describe the period, will be controlling.

Two other 1932 changes, described as "new matter . . . without retroactive effect,"¹¹⁵ were: (1) addition of the words "or for any period not ascertainable without reference to [the transferor's] death"; and (2) addition of the reference to a right retained by the transferor "in conjunction with any persons."

Although the joint resolution did not explicitly exempt transfers made before its enactment, it was long construed to do so. In 1947, however, this issue was reopened by the Supreme Court on its own motion, when it ordered reargument in a pending estate tax case, *Commissioner v. Estate of Church*,¹¹⁶ involving a pre-1931 trust under which the grantor had retained both a life estate and a reversionary interest in the corpus. Although the government had included the trust assets in the decedent's gross estate solely because of the retained reversionary interest and adhered to this ground on reargument, it also urged the Court to overrule *May v. Heiner*.¹¹⁷ The Court, by a divided vote, did so, holding that *May v. Heiner* was wrongly decided under pre-1931 law and that it was not implicitly ratified for pre-1931 transfers by the joint resolution of March 3, 1931.

Although Congress had repudiated *May v. Heiner* in 1931, it now responded to this judicial repudiation of *May v. Heiner* by going to the opposite extreme. In several steps, beginning less than a year after *Estate of Church* was decided, Congress enacted the statutory predecessor of section 2036(c), which in effect restored the mantle of immunity conferred by *May v. Heiner* to transfers made on or before March 4, 1931.¹¹⁸ Section 2036(c) also provides that transfers made between

114. H.R. REP. NO. 708, 72d Cong., 1st Sess. (1932), reprinted in 1939-1 C.B. 457.

115. *Id.* The prospective-only principle of these two changes is presently reflected in the second clause of § 2036(c) and in Treas. Reg. § 20.2036-1(a)(1960) ("not ascertainable" rule and retention of rights to designate in conjunction with any other person or persons apply only to transfers after June 6, 1932).

116. 335 U.S. 632 (1949).

117. 281 U.S. 238 (1930).

118. Technical Changes Act of 1949, ch. 720, 63 Stat. 896. See generally Bittker, *The Church and Spiegel Cases: Section 811(c) Gets a New Lease on Life*, 58 YALE L.J. 825 (1949); Bittker, *Church and Spiegel, The Legislative Sequel*, 59 YALE L.J. 395, 414-18 (1950); Pavenstedt, *Congress Deactivates Another Bombshell: The Mitigation of Church and Spiegel*, 5 TAX. L. REV. 309 (1950). For the final step in the legislative rejection of *Church*, see H.R. REP. NO. 894, 83d Cong., 1st Sess. (1953), reprinted in 1953-2 C.B. 508, 513.

March 3, 1931, and June 7, 1931 are not taxable unless they would have been taxable under the joint resolution of March 3, 1931. This grandfather clause preserves the non-retroactivity of the two 1932 substantive amendments to the joint resolution.¹¹⁹

The immunity conferred by section 2036(c) applies only to "a transfer made" before the specified dates, and does not protect property added thereafter to a pre-1931 trust.¹²⁰ Moreover, pre-1931 contributions to a trust may lose their immunity if the grantor amended the instrument after 1931 or had the power to revoke it, since the transfers may then be treated as "made" at a later date.¹²¹ Finally, pre-1931 transfers are not protected by section 2036(c) from being taxed under other independently applicable provisions; for example, section 2038 will apply if the decedent reserved a power to amend or revoke the transfer.¹²²

119. See *supra* note 115 and accompanying text.

120. See, e.g., *Estate of Thomson v. Commissioner*, 495 F.2d 246 (2d Cir. 1974) (post-1931 trust income was transferred to pre-1931 trust when accumulated, where grantor had power to accumulate or distribute it); *Pearson v. Commissioner*, 36 B.T.A. 5 (1937); *Estate of Curie v. Commissioner*, 4 T.C. 1175, 1181-82 (1945) (dictum).

121. See *Commissioner v. Estate of Talbott*, 403 F.2d 851 (4th Cir. 1968), *cert. denied*, 393 U.S. 1022 (1969) (pre-1931 trust held taxable where grantor reserved power to revoke until 1935); *Maclean v. United States*, 275 F.2d 936 (9th Cir. 1960) (revocation of pre-1931 trust followed by transfer of assets in trust treated as creation of new trust, not as continuation of old one). See also *Savage v. United States*, 331 F.2d 678 (2d Cir. 1964) (transfer of insurance proceeds occurred when revocable settlement option became effective on insured's death, not at pre-1931 date when policies were taken out and option was elected). But see *Commissioner v. Estate of Canfield*, 306 F.2d 1 (2d Cir. 1962) (release of reserved testamentary power of appointment over corpus of pre-1931 trust did not forfeit immunity).

122. See *Florida Nat'l Bank v. United States*, 336 F.2d 598 (3d Cir. 1964), *cert. denied*, 380 U.S. 911 (1965) (pre-1931 trust under which grantor reserved both life estate and power to amend held taxable under § 2038 because of power to amend; immunity conferred by § 2036(c) does not preclude tax under § 2038).